Sale-ing into turbulent waters

Global Retail Discount Pricing Litigation and Regulation

Hogan Lovells

The Problem

California retailers are under increased scrutiny and pressure from plaintiffs, concerning their pricing practices, which often include tags that compare an "original" or "regular" price to a current "sale" or "discount" price. This article discusses litigation trends that we have observed in this area, the attendant risks that retailers face, and suggests that retailers establish comprehensive pricing policies and audit protocols to avoid liability for deceptive sale pricing.

The guidance offered in this article is equally applicable in parts of Europe and Asia, where the reference price must have been an actual sale price (sometimes for a stated period of time) in both offline and online sales. The difference is that the risk in these jurisdictions is primarily of government investigations and penalties and challenges by competitors and consumer groups, and not consumer class actions like in the U.S. However, in the UK there is a new consumer class action right which is currently untested but which has the potential to lead to class actions similar to those in the US.

In Asia, China and Hong Kong, for example, have advertising and consumer protection laws that prohibit false or deceptive pricing information or comparison from being used. For instance, it is prohibited to make up an "original" price to create a false impression of discount when that original price has never been used or has only been used for a very short time. Authorities have fined offenders or required offenders to enter into written undertakings to rectify. Aggrieved consumers have redress against the offenders too, although in Asia class actions are relatively rare.

The same applies for most European jurisdictions, where consumer and retail trade regulations impose rules for more transparent pricing and provide protection against misleading pricing. This is a particularly hot topic, and in the UK has recently been the subject of a consumer super-complaint in the groceries sector.

The increased scrutiny that retailers are facing around the world is of course also explained by the massive growth of online sales. E-commerce companies are competing heavily for their share of the online consumer's wallet, and this can entail aggressive advertising and pricing practices – often with exaggerated discounts and comparisons with misleading "original" prices.

California's False Advertising Statute Explicitly Prohibits Deceptive Sale Pricing

In California, the advertisement of the "original," "former" or "regular" price of an item is governed by Section 17501 of California's Business & Professions Code, which provides, in relevant part:

No price shall be advertised as a former price of any advertised thing, unless the alleged former price was the prevailing market price as above defined within three months next immediately preceding the publication of the advertisement or unless the date when the alleged former price did prevail is clearly, exactly and conspicuously stated in the advertisement.

The Federal Trade Commission Guides Against Deceptive Pricing, which was issued over 25 years after Section 17501 was enacted, offers additional guidance, but does not alter the requirements of the California statute. For example, the FTC Guide advises, "If the former price is the actual, bona fide price at which the article was offered to the public on a regular basis for a reasonably substantial period of time, it provides a legitimate basis for the advertising of a price comparison." See 16 C.F.R. § 233.1(a). The Guide offers several examples of fictitious price comparisons, including where a price "was not used in the regular course of business, or which was not used in the recent past but at some remote period in the past, without making disclosure of that fact," or where a price "was not openly offered to the public, or that was not maintained for a reasonable length of time, but was immediately reduced." See 16 C.F.R. § 233.1(d).

Litigation Involving Section 17501 Has Accelerated

A California court first cited Section 17501 in the 1971 case of Faberge, Inc. v. Saxony Products, Inc., 1971 WL 16493 (C.D. Cal. Jul. 28, 1971).

In that case, the court found that the defendant's repeated representations to the plaintiff that its "fair trade" price for its lotion product was $6.00 violated Section 17501, because the lotion had "never sold for anything approaching $6.00." Id. That simple 3-page opinion identified what would become the crux of dozens of lawsuits involving allegedly deceptive sale pricing practices in the years to follow. And especially in the last decade, the California plaintiff's bar has identified retail pricing practices as a fertile area for threatened litigation and "quick-hit" settlements. Unfortunately, California courts have issued several opinions in recent years that have done nothing to deter these plaintiffs. Although these cases represent the views of just a few courts, retailers should take them seriously.

It has become easier for plaintiffs to plead standing

Historically, defendants could contest a plaintiff's standing to sue at the pleading stage, on the basis that the plaintiff purchased the product and paid the advertised price, and thus received what was paid for. This became known as the "benefit of the bargain" theory. This changed in 2013. In Hinojos v. Kohl's Corp., 718 F.3d 1098 (9th Cir. 2013), the plaintiff alleged what has become the quintessential fact pattern under Section 17501. The plaintiff allegedly purchased luggage that was advertised as 50% off its "original" price of $299.99, and various items of clothing that were marked between 30-40% off their "original" prices. Id. at 1102 n.1. The plaintiff alleged that the so-called "original" prices were false, because the items were routinely sold at the advertised "sale" prices, and the so-called "original" prices did not reflect prevailing market prices during the preceding three months. Id. These basic allegations, with slight variations based on the circumstances, form the basis of dozens of lawsuits filed against retailers over the last five years.

Shortly after the Hinojos court dismissed the false advertising claims based on the "benefit of the bargain" theory, the California Supreme Court issued a decision in a separate case that established the minimum requirements for pleading standing under California's false advertising law. The Court held that a plaintiff need only plead that he or she (i) relied on the advertised former price, and (ii) would not have purchased the item otherwise. Kwikset Corp. v. Superior Court, 51 Cal.4th 310 (2011). Since the Hinojos plaintiff had met these basic Kwikset requirements, the Ninth Circuit reversed the dismissal, expressly rejecting any suggestion that a plaintiff must plead how much he or she would have paid had the true market value of the item been known (718 F.3d at 1105), rejecting the "benefit of the bargain" theory. Id. at 1107. Although standing had not been a particularly difficult standard to meet, these recent decisions seem to have further relaxed the standing requirements at the pleading stage.

Plaintiffs may have standing to sue for products they did not purchase

Because retail pricing cases typically involve relatively low-priced goods with individual plaintiffs who have suffered only nominal damages (if any), plaintiffs typically file the suits as class actions, seeking to represent a statewide or nationwide group of similarly situated individuals. While the named plaintiff usually will have purchased one or more items from the retailer, it is common for the proposed class definition to be more ambitious – seeking to include all individuals who purchased any item at the retailer that had the same pricing defect, not just the products the named plaintiff purchased. This raises obvious standing concerns – how can a plaintiff assert claims against products he or she did not even buy? Although courts have disagreed on this topic, retailers should be aware of a recent California Court of Appeal decision called Branca v. Nordstrom, Inc., 2015 WL 10436858 at *7 (S.D. Cal. Oct. 9, 2015) ("Branca II"), in which the court ruled that class representatives in retail pricing cases have standing to represent class members who purchased items that the representative did not purchase, as long as the item and its tags reflect the same type pricing practice (e.g., "Original," "Compare At," etc.). Branca II, 2015 WL 10436858 at *5 ("[I] t is immaterial for the purposes of his claims whether one purchased a pair of shoes versus a hat, so long as the item bore a 'Compare At' tag"). This ruling has not been affirmed by the Ninth Circuit or adopted by other courts, but if this becomes the majority view, it may make it more difficult for retailers to eliminate non-purchased items from the proposed class.

A series of rulings on motions to dismiss potentially provide a roadmap for plaintiffs to plead violations of section 17501

Two federal court decisions that came down in 2015 show that threadbare allegations that merely describe the retailer's pricing practices, without sufficient allegations concerning the plaintiff's reliance or damages, will likely be insufficient to survive a motion to dismiss. Rubenstein v. The Neiman Marcus Group LLC, 2015 WL 1841254 at *5 (C.D. Cal. Mar. 2, 2015) ("Compared To" prices, coupled with the store name "Last Call," did not imply that the items were originally sold at Neiman Marcus flagship stores) (granting motion to dismiss); Branca v. Nordstrom, Inc., 2015 WL 1841231 at *4 (S.D. Cal. Mar. 19, 2015) ("Branca I") (plaintiff failed to allege that he relied on the "Nordstrom Rack" name). However, these decisions urging the plaintiffs to provide more detail have (perhaps unwittingly) shown plaintiffs what they need to plead in order to overcome a motion to dismiss.

For example, in Branca the plaintiff simply amended the complaint and bolstered the claims with additional allegations that (i) at the time of purchase, the plaintiff believed the "Compare At" price was a former price, or a prevailing market price, because he believed it would be a "savings" only if it related to the same product; (ii) the plaintiff believed that items with "Compare At" prices were discounted, while other items were not; (iii) reasonable consumers would be deceived in the same way he was; and (iv) survey evidence showed that 90% of consumers interpreted the "Compare At" tag to mean that the item was previously sold for the higher price. Branca v. Nordstrom, Inc., 2015 WL 10436858 at *7 (S.D. Cal. Oct. 9, 2015) ("Branca II"). The plaintiff also used Nordstrom's pricing compliance manual, which described the sale price on the tags as the "MSRP" or "Regular Retail" price. Id. With these additional allegations and evidence, Nordstrom's motion to dismiss was denied. While this ruling is limited to its facts, we anticipate that retail pricing plaintiffs will attempt follow Branca's lead and mirror these allegations where possible.

Another recent ruling certifying a class of consumers against J.C. Penney illustrates the type of discovery that retailers are likely to face

In May 2015, a California federal court certified a class of consumers who alleged that J.C. Penney's "sale" prices violate Section 17501. Federal Rule 23, which governs class certification, has several requirements, but the two that often dictate the outcome of a motion for class certification are that (i) there must be common questions of law or fact common to the class, and (ii) the common questions must "predominate" over individual issues that could be raised by different class members. In the false advertising context, especially in the retail environment, plaintiffs had faced some challenges when trying to meet these requirements, because consumer perception varies from person-to-person, and not everyone views and relies on advertising and labeling in the same way.

However, in Spann v. J.C. Penney Corp., 307 F.R.D. 508 (C.D. Cal. 2015), the court found that both the commonality and predominance class action requirements had been satisfied. It framed the common issues rather generically: (i) whether the alleged pricing scheme was false or misleading, (ii) whether defendant made false statements, (iii) whether reasonable consumers are likely to be deceived, (iv) whether the misrepresentations were "material" to plaintiffs, (v) how to calculate the "prevailing market price," (vi) whether the regular price was the "prevailing market price," (vii) whether the retailer ever intended to sell its products at the regular price, and (viii) whether the plaintiffs were damaged. Id. at 518. Due to the way that the court framed these issues, plaintiffs may attempt to adapt them to their situations to overcome the commonality hurdle.

In addition, the plaintiffs in Spann used several of J.C. Penney's own documents and data sources against it to support class certification. The retailer's internal pricing guidelines for its buyers instructed that (i) only 5-10% of the initial shipment should be sold at the regular price, and (ii) after a 14-day "landing period" the products could all be marked down to the sale price. Id. at 520. And the company's sales and pricing data showed that buyers routinely set regular and sale prices in advance of the first sale, and the vast majority of items were either never offered at the regular price or had only nominal sales at that price. Id. at 520-521. The court found that this evidence, which was common to all plaintiffs, could be used to answer all of the common questions presented. This decision previews for retailers the types of information that plaintiffs are likely to seek in discovery and put before the court in a motion for class certification. With this in mind, retailers must take extra care to ensure that its policies provide guidance and control measures that are fully consistent with applicable law.

Class plaintiffs still face significant hurdles

In consumer class actions, plaintiffs often face significant difficulty establishing an adequate damages model at the class certification stage. In fact, several consumer cases in the food labeling context are currently pending before the Ninth Circuit on this very issue, and the resolution of those cases will likely guide the law in the greater retail context. Although plaintiffs continue to seek a "full refund" or "full disgorgement" of profits or revenue, the courts have almost unanimously rejected these models, with the understanding that the plaintiffs received some value from the products they purchased. Plaintiffs, and their retained experts, continue to struggle to present models that represent the difference between what they spent and the value they actually received. This dilemma was discussed in the recent decision called Chowning v. Kohl's Department Stores, Inc., 2016 WL 1072129 (C.D. Cal. Mar. 15, 2016), in which the court granted summary judgment in favor of the retailer, because the plaintiffs failed to present an acceptable damages model.

An Effective Pricing Compliance Program Is Critical

In light of the foregoing trends, in which it has become increasingly difficult to defeat consumer claims at the pleading stage, and California retailers become exposed to the significant costs and attorneys' fees typically associated with intrusive discovery and class certification, retailers should closely scrutinize their pricing policies to ensure that they comply with applicable law. Where prices are marked in comparison to an "original" or "regular" price, the retailer must have data showing that the item was actually offered for sale at those prices for a substantial amount of time prior to setting the discounted price. In addition to setting comprehensive and consistent pricing policies, retailers are advised to implement an internal audit and control protocols to ensure that its policies are consistently followed. These measures will go a long way toward deterring pattern litigation and resisting class certification in the cases that do get filed.

Having an effective pricing compliance program is equally important for retailers in terms of reducing their risks under the growing body of pricing laws and regulations in other parts of the world too (such as Asia and Europe). In particular, retailers who offer their products online are often exposed to pricing regulations in different jurisdictions. It is critical for retailers to make sure that their pricing practices comply with local laws.

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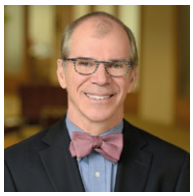

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